Event Report: ‘Market or Racket: do we need a new approach to executive pay?’

The Politics of Pay

Rachel Reeves, Labour MP for Leeds West and Chair of the House of Commons Select Committee for Business, Energy and Industrial Strategy
In conversation with Tom Gosling, Executive Fellow, London Business School and Partner at PwC

Rachel Reeves spoke to Tom Gosling about the politics of pay.

Gosling began by asking Reeves what motivates the political interest in executive pay and how this comes through to her as an elected representative. Reeves said pay fairness is at the very heart of the issue, both for senior executives and workers. She explained that in her constituency in West Yorkshire average pay is only around £20,000 a year, while many chief executives earn this amount just in the first few days of January. Reeves argued that this large pay discrepancy was unfair, as the success of a company depends not just on one man or woman at the top, but on the whole workforce “pulling their weight and doing their best.” She said that while she does not believe that everyone should be paid the same, she would like to have a system where rewards are more evenly distributed. Reeves said it is also important to consider the political shift seen globally in recent years, through the rise in populism, with many people feeling they are being left behind economically.

Gosling outlined how the way in which executive pay operates in the UK has transformed since around 2003, with shareholders being given more powers, pensions coming down, more performance related pay, and longer-term schemes. He raised the BEIS Committee’s last report, saying it appeared to suggest that increased shareholder powers had been a failure in terms of executive pay. Reeves said before that inquiry, she had regarded more active shareholders and owners of companies as the solution. However she said that when the committee took evidence from institutional shareholders in that inquiry and also on the inquiries into the collapse of Carillion and Thomas Cook, she was quite disappointed with shareholders’ responses, particularly those of index funds, which was a factor in changing her view on this.

On the topic of executive pay levels, Reeves expressed her anger that some companies do not pay their workforce the living wage, yet their executives reap large rewards. She gave the example of Persimmon’s former CEO being given a bonus of £75 million, despite not all the company’s employees receiving the living wage. Reeves said that one in five workers in the UK are not paid a wage they can afford to live on, and said she felt it was not right that the taxpayer should need to subsidise the wages of people working for big successful companies. Reeves said that the Persimmon compensation scheme was poorly designed, with executives being rewarded for government policy (the Help to Buy scheme) and the share price boost that followed.

Gosling asked whether Reeves felt that the current typical FTSE 100 CEO pay level, between around £3.5 and 4 million, was too high. Reeves said that the issues of how earnings are distributed and inequality in society are what concern her the most. She said, “there is something quite badly wrong when you’ve got such extremes and I don’t think you’re going to have a well-functioning society.” Reeves said that if companies can afford to pay their top executives £4 million a year, they can afford to pay decent wages to those in the bottom and middle of their workforce also. She questioned why workers are not valued and rewarded more, and why their pay has barely increased over the last few years. Gosling said what he was hearing from Reeves was more of a focus on fairness and the responsibility of boards to improve pay for the wider workforce than taking money off certain senior executives. Reeves said that this was true, and that companies’ successes are
based on not just those at the top, but the good people in the wider workforce. Reeves made the point that if you pay your workers more, you will incentivise them and might get even better results. She said that workers should be rewarded fairly and should be given a say on remuneration for those at the top.

In the audience, a FTSE 100 reward director suggested that the tax and benefit system should be the best way to address inequality. Reeves disagreed. She said if you look at OECD countries and the distribution of earnings before the tax and benefits system, the UK has one of the worst unequal distributions, and that this only rises to middle of the OECD table once the tax and benefits system factors in. Reeves said this shows the amount of work the state needs to do to compensate for unequal distribution of earnings from companies to workers. Reeves also pointed out that taxes not only provide a social safety net but are used to fund vital infrastructure for businesses and society.

Another member of the audience brought up pensions and how pension rights, including final salary pensions, have deteriorated over the past 30 years. Reeves said that she agreed that true earnings have not kept pace with the cost of living and that deferred earnings through pensions for workers have taken a hit. Reeves said that automatic enrolment into workplace pensions were a positive development that was redressing the balance a bit, bringing millions of people into saving for pensions. Reeves also highlighted the case of Carillion. She noted that none of the Carillion executives had paid into the company’s pension fund. She said she found it shocking that none of the executives lost out in terms of pensions or had to pay back bonuses when Carillion went bankrupt.

Gosling asked whether there is a trade-off between prioritising value for shareholders, many of whom are people in stakeholder pensions, and worker wages. Reeves answered that it is good business sense to pay people a decent wage. She said that boards of companies and remuneration committees should think about incentive structures to get the most out of workers. She noted that during an earlier panel in the CCG event people had expressed the view that senior executives are not primarily motivated by money. Reeves said that she could not reconcile how executives claim to be motivated by more than just monetary compensation but fail to prioritise the wellbeing of their workforce. She asked why if money is not the motivating factor for executives, that they do not ensure their companies change to better reward all workers. Gosling disputed earlier claims that money is not a strong motivating factor for many CEOs and said that much research evidence suggests that CEOs tend to overstate other motivating factors.

An academic in the audience asked Reeves for her perspective on the impact of globalisation on global workforces and wages, and whether forcing companies to raise worker wages risks jobs being outsourced overseas or losing them to new technologies. Reeves responded that she believes a market-based economy is the best way to lift people out of poverty and that she also wants to have a strong state to provide public goods and a safety net for those who need it. Reeves argued that in the UK and US, “business has got too powerful, markets have got too strong, the state does not do enough.” She said that there is a balance to be struck and at the moment this balance between executive and worker pay was not quite right. She said “I don’t want to throw the baby out with the bathwater. I want to have a system that rewards everybody that contributes to success.” She reiterated her belief that if you invest in a workforce and train and compensate people fairly, you incentivise them to better contribute to the company’s growth. Reeves noted that businesses are often fearful of improving worker compensation and gave the example of the introduction of the UK minimum wage for workers in 1999. She said that many businesses had warned this would lead to a huge increase in unemployment, but that with greater investment in the workforce it achieved record employment and lifted many people out of poverty.
Reeves concluded the discussion with her vision for executive pay for the future. She said that despite some reservations she would like to see shareholders play a more active role, to reduce some of the rewards for failure and to challenge remuneration committees about the structure of their pay. Reeves added that there should also be stronger mechanisms in place for clawing back pay when businesses fail. She encouraged boards and remuneration committees to devise systems that are fair and sustainable, to attract and retain business talent for the UK, but also to better reward people in the workforce who keep those businesses going. Reeves warned that unless business addresses these issues, there will be a greater clamour for politicians to do so.